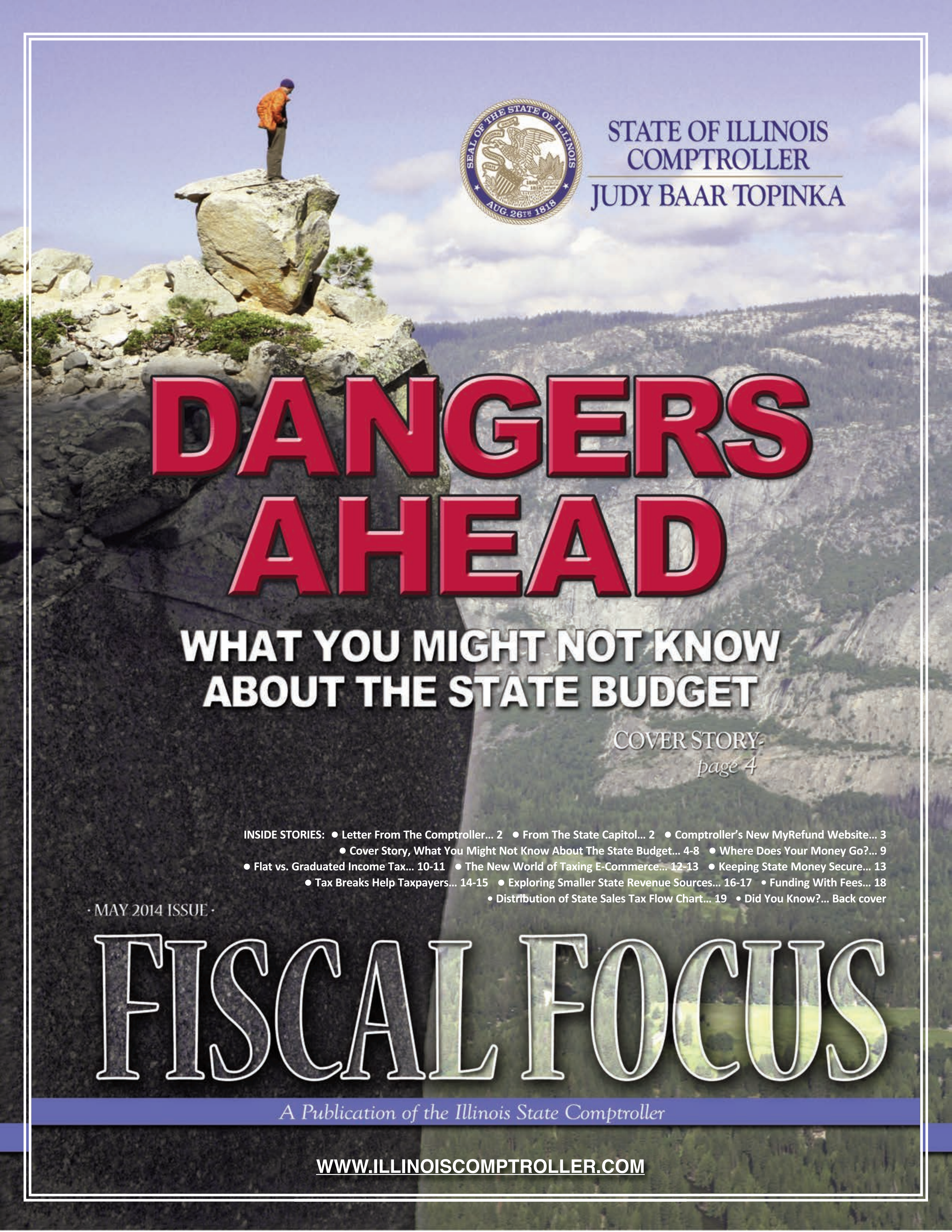


STATE OF ILLINOIS COMPTROLLER
JUDY BAAR TOPINKA

DANGERS AHEAD

WHAT YOU MIGHT NOT KNOW ABOUT THE STATE BUDGET

COVER STORY- page 4

INSIDE STORIES: ● Letter From The Comptroller... 2 ● From The State Capitol... 2 ● Comptroller's New MyRefund Website... 3
● Cover Story, What You Might Not Know About The State Budget... 4-8 ● Where Does Your Money Go?... 9
● Flat vs. Graduated Income Tax... 10-11 ● The New World of Taxing E-Commerce... 12-13 ● Keeping State Money Secure... 13
● Tax Breaks Help Taxpayers... 14-15 ● Exploring Smaller State Revenue Sources... 16-17 • Funding With Fees... 18
• Distribution of State Sales Tax Flow Chart... 19 • Did You Know?... Back cover

· MAY 2014 ISSUE ·

FISCAL FOCUS

A Publication of the Illinois State Comptroller

WWW.ILLINOISCOMPTROLLER.COM

State of Illinois Comptroller
Judy Baar Topinka

Taxing times for Illinois

Most Illinoisans are all too aware of the state's fiscal problems. Hardly a day goes by without a newspaper article about late state payments to businesses, the state's pension challenges, or endless arguments among lawmakers about what programs to fund or cut. An increase in the state income tax rate in 2011 helped with the state's cash flow issues, but it clearly didn't solve the problem, and the rate is scheduled to drop in 2015, reducing revenue by almost $5 billion by fiscal year 2016.

So what's the solution? It depends on who you ask. Some people would like to make the 2011 tax increase permanent. Others feel that Illinois' income tax structure is inherently flawed and are advocating a change to a graduated tax system with higher rates on higher income. On the other side, some people want to cut government programs and services. Others claim that Illinois' taxes are already too high and are driving people and businesses out of the state, and suggest that lowering tax rates would stimulate enough economic growth to make up the lost tax revenue.

One thing that almost everyone can agree on is that something must be done, because the situation is dire. As we discuss in the cover story, besides Illinois' obvious problems, one thing that many people are not yet even talking about is the possibility of another recession. The last recession officially ended more than four years ago, although Illinois has been slower to recover. National Bureau of Economic Research data shows that the average length of an economic expansion in the modern era is just less than five years.

This is a critical time for Illinois' future. Decisions made by today's lawmakers could determine whether the state can pull itself out of its current hole, or continue to flounder. This issue of *Fiscal Focus* takes an in-depth look at these timely issues, including the 2011 tax increase and what will happen if it decreases as scheduled, the merits of flat versus graduated income taxes and what other states do, the cost of tax expenditures, state revenues from other sources, proposals to tax e-commerce, and where the state spends its money.

We hope you find this issue of *Fiscal Focus* to be informative. If you have any comments, please feel free to share them with us at (217) 782-6000 or at our website www.illinoiscomptroller.com.

Judy Baar Topinka
Illinois State Comptroller

~ From the State Capitol ~

COMPTROLLER OFFERS "FOLLOW THE MONEY" WORKSHOPS

Topinka Teams up with CPA Society and the FBI to offer sessions to local governments

Partnering with the FBI and the CPA Society, Comptroller Topinka launched a new workshop series for elected officials to help them better understand their budgets and how to identify fraud and corruption.

The Follow the Money workshops took place in seven cities around the state from April 22 to April 24. Topinka sent invitations to local elected officials in these communities and their executive staffs asking them to attend.

"This is a unique opportunity to hear from the experts on how to make our government become more accountable, transparent and efficient," added Topinka. "We need to be diligent about working to prevent fraud and corruption in all levels of government."

To learn more about these workshops please visit the Comptroller's website at www.illinoiscomptroller.com and click on Follow the Money.

FOLLOW THE MONEY SERIES
PROTECT EVERY DOLLAR

Comptroller's New MyRefund Website Draws More Than 300,000 Visits

Free Resources Help Taxpayers Follow Their Money

Since the launch of Comptroller Topinka's MyRefund website in February, more than 50,000 people have signed up to receive notifications by email or text indicating when their Illinois tax refund is on the way.

The easy-to-use resource allows taxpayers to see if their payment has been processed by the Comptroller's Office by simply entering their name and Social Security number on the new website. Taxpayers also have the opportunity to enter an email address and mobile phone number to receive notification when their payment is processed.

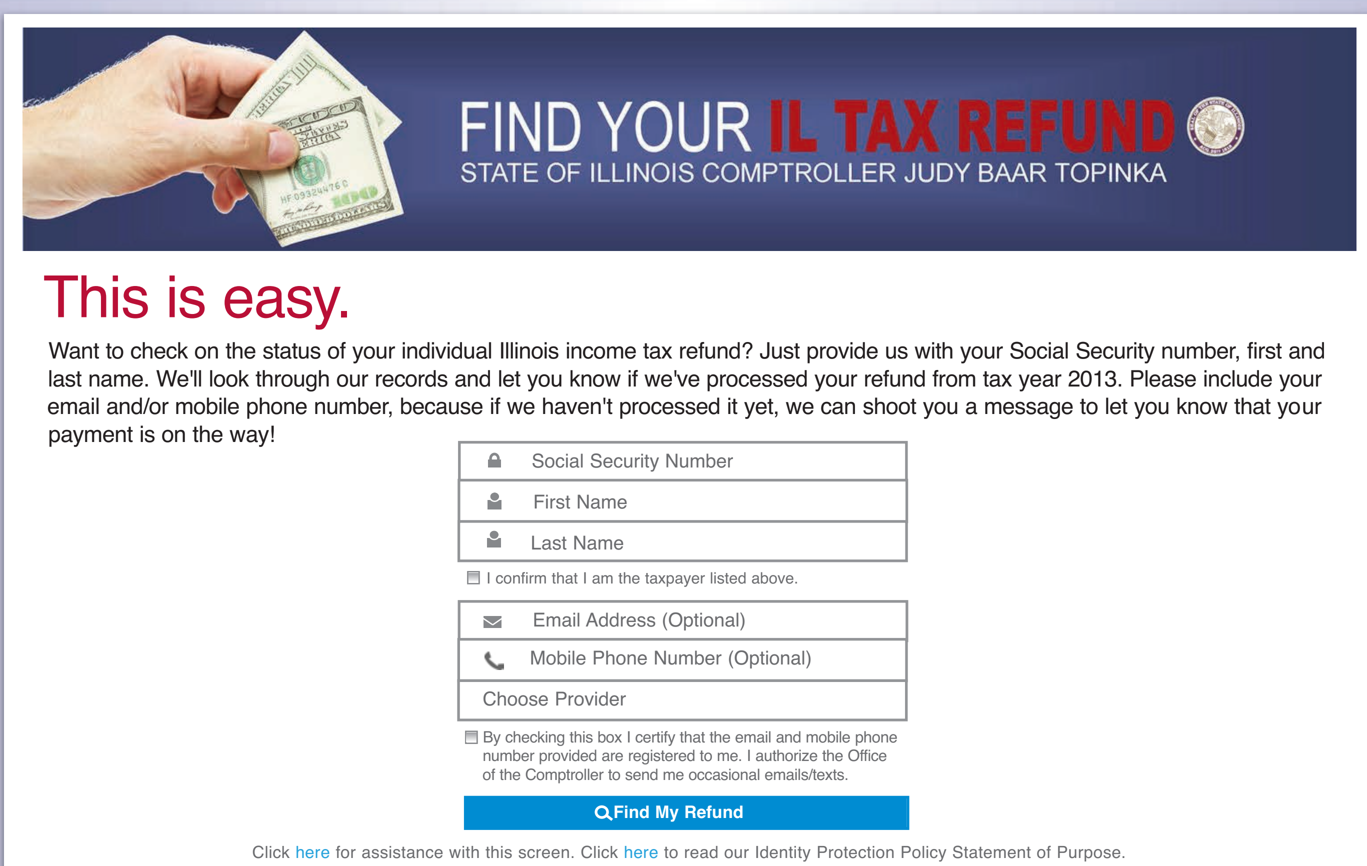
"Taxpayers no longer have to wonder if the check is the mail," Topinka said. "By simply visiting the site and submitting an email address, they can be assured that they will be notified immediately after their payment is processed."

Also this tax season, Topinka included a state spending insert in every tax refund envelope, and made the information readily available online.

"There should be no mystery when it comes to public dollars in this state," Topinka said. "Residents should know exactly where their money is spent and they shouldn't have to dig for it. This insert gives taxpayers insight into state spending and directs them on where to go for even more detail."

These initiatives are part of Topinka's ongoing effort to increase transparency and accountability in state and local government. In launching the Ledger, http://ledger.illinoiscomptroller.com and Warehouse, http://warehouse.illinoiscomptroller.com web portals, she enabled taxpayers to click their way through everything from the state's daily bill backlog numbers to state agency budgets, employee salaries and local government financial information.

"As I've always said, if we can keep creating tools that give the public better access to government, we're going to do it," Topinka said. "And we're not finished yet. Stay tuned." ■



What You Might Not Know About The State Budget

A TALE OF TWO CLIFFS

SIGNIFICANT REVENUE DECREASES FOR THE STATE ON THE HORIZON

In seven months, millions of Illinoisans will have more money back in their pockets when the temporary income tax increase begins to roll back—but in turn, the state will have billions less to spend on schools, roads, bridges, public safety and other government programs. Legislators and the Governor increased the income tax rate in 2011 and it is scheduled to start dropping back down at the beginning of 2015. This alone will create a significant impact on the State of Illinois' budget but ANOTHER challenge for state revenues may be just over the horizon–the economy.

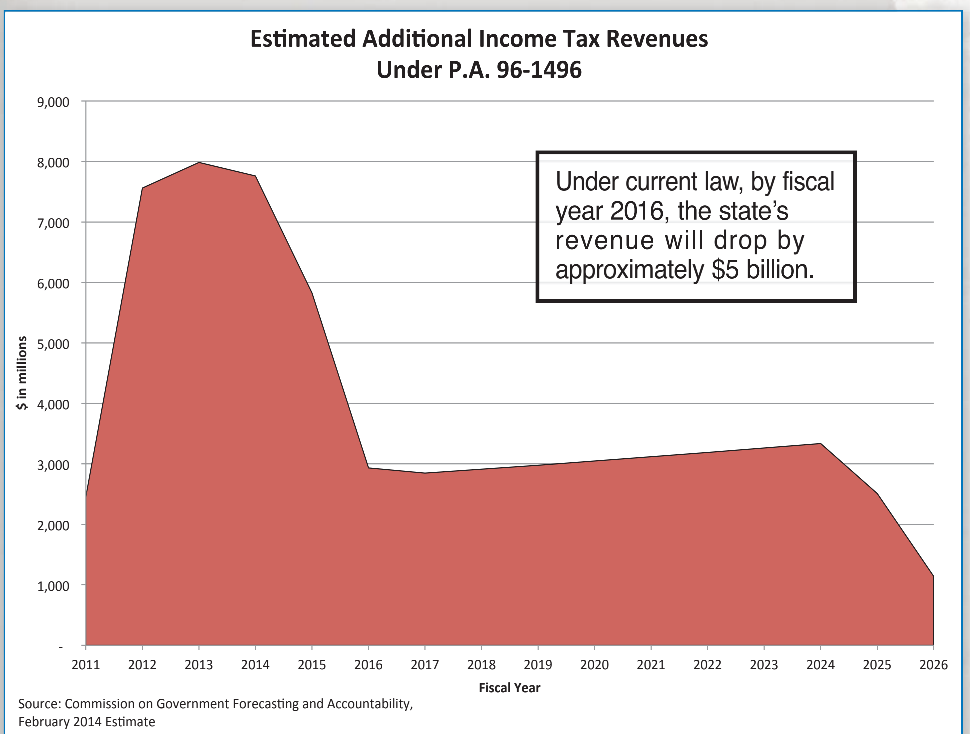
Any meaningful discussion of the budget this spring cannot be undertaken without a review of the state's tax system and an understanding of the state's major revenue sources and their dependence on the economic cycle. In addition to the scheduled decrease of a significant revenue source, legislators and the Governor will also have to consider the state's challenging payment delays and spending pressures.

OVERVIEW OF MAJOR REVENUE SOURCES

The State of Illinois imposes taxes and generates revenues from a variety of sources. The major revenue sources for the state's General Funds (the collective name for four funds that support the state's major operations) include income taxes, sales taxes, public utility taxes, cigarette taxes, riverboat gambling taxes and fees, and proceeds from the state lottery. The state also collects significant amounts of revenue from the federal government, primarily through matching revenues for specific programs or block grants. The General Funds are usually the primary focus of policy makers' debates and will be the basis of this report.

Some major sources of revenues that will be excluded from the report include items such as motor vehicle licenses and fees, the motor fuel tax, and proceeds from bond sales which are deposited into separate funds outside of the General Funds for a specific purpose. Other revenues, such as local governments' share of the sales tax or Corporate Personal Property Replacement Taxes (PPRT) are also collected by the state, but are deposited into separate funds and passed on to the local governments.

The income tax is the largest generator of state source revenue. First authorized by statute in 1969 and increased in 1989 and 2011, the State of Illinois currently imposes an income tax of 5.0 percent on individuals and 7.0 percent on the taxable income of corporations (excluding the 2.5 percent PPRT). Working from the federal Adjusted Gross Income (AGI) level, Illinois allows a few standard exemptions for individuals (such as retirement income and $2,050 for each individual in the household) plus a few tax credits (such as 5 percent of the property taxes paid on the taxpayer's principal residence) to determine the level of tax owed. Corporations are also allowed various credits against their federal AGI before computing Illinois taxable income; additionally, multi-state corporations are able to pro-rate their total income based on sales within Illinois. Since 1989, a portion of total income tax collections has been set aside for refunds before the rest is deposited into the General Funds.



The second largest state source of revenue is the sales tax which has also been modified over the years. The base uniform tax rate is 6.25 percent of the purchase price, with the state keeping 5 per-

— continued on next page

WHAT DOES THE TAX RATE CHANGE MEAN TO YOU?

On January 1, 2015, Illinois' individual income tax rate is scheduled to drop from 5.0% to 3.75%.

For most* families of two with federal AGI of $50,000, the tax rate drop would cut their tax payments by about $570.

For most* families of four with federal Adjusted Gross Income (AGI) of $75,000, the tax rate drop would put approximately $825 back into their bank accounts.

For a typical* single person with a federal AGI of $35,000, the tax rate change would reduce her taxes by about $410.

**for taxpayers with few Illinois additions or subtractions*

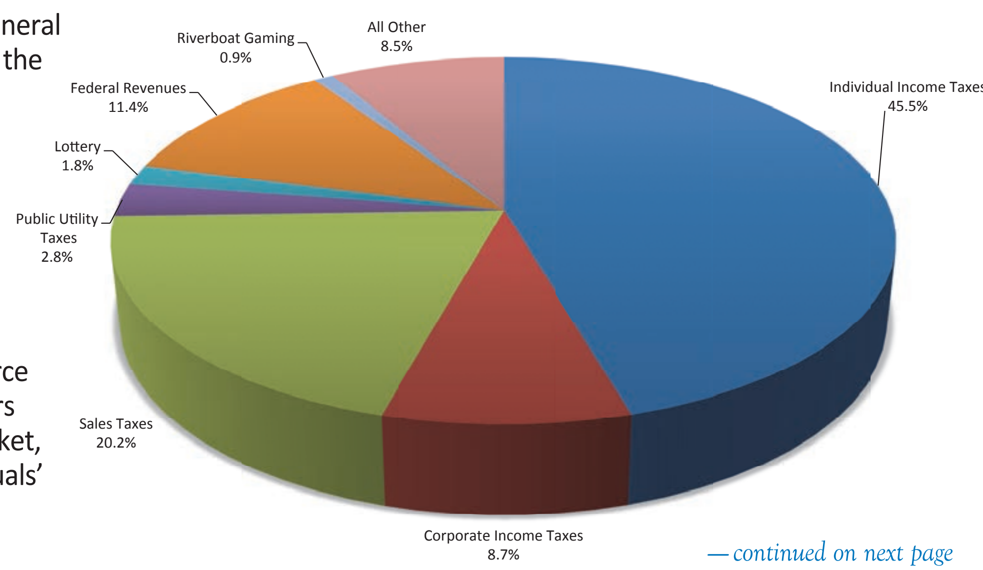
cent and distributing 1.25 percent of the revenue back to the local governments. Food and drug purchases are only charged a 1 percent tax which is distributed to local governments. Local governments (such as the Regional Transportation Authority and home-rule units) are allowed to charge additional sales taxes on top of the 6.25 percent base rate. Most of the revenue from the state's portion is deposited into the General Funds with a small portion set aside for Build Illinois bond debt service and other purposes (see the chart on p. 19). Significant exemptions from the state sales tax base are food and drug purchases, sales to exempt organizations, traded-in property, and farm chemicals. Additionally, most services provided in Illinois' economy are exempt from the sales tax.

The next largest revenue sources for the General Funds are public utility taxes. These include the telecommunications tax, electricity tax, and natural gas tax. The electricity and gas tax are usage-based taxes; therefore, revenues from these taxes will increase or decrease based on weather and related use of these items. The telecommunications tax is 7 percent of gross charges, of which 6 percent of the total 7 percent is deposited into the General Funds. Revenues from this source have been relatively stagnant in recent years as changes in the telecommunications market, primarily cell phones, have reduced individuals' expenditures.

The so called "sin" taxes also make significant contributions to the General Funds tax base. These include cigarette and liquor taxes, gaming taxes and fees, and proceeds from the state's lottery. These items are discussed in the article on p. 16, but notably have grown in importance for the state's revenue picture. Over the last 15 years, increases in spending have often utilized increases in these taxes to pay for the added costs and to bolster the tax base.

The General Funds receive well over half of the state's revenues including the predominant share of income and sales taxes. In fiscal year 2013, total base revenues into

FY 2013 General Funds Base Revenues
$36.3 billion



— *continued on next page*

the General Funds (excluding transfers from the Budget Stabilization Fund) equaled $36.328 billion. Individual income taxes were over 45 percent of all revenues and sales taxes totaled just over one-fifth of total revenues. Federal revenues totaled 11.4 percent of the sum, while corporate income taxes and public utility taxes were 8.7 percent and 2.8 percent, respectively, of total receipts.

Individual income taxes, corporate income taxes and sales taxes are the most significant state sources of revenue deposited into the General Funds. Receipts from income and sales taxes totaled $27.070 billion in fiscal year 2013 and represented 84.1 percent of total state sources of revenue and 74.5 percent of total base revenues last year.

PUBLIC ACT 96-1496

Over recent history, the reliance on income and sales taxes has remained consistently high. But the share of state revenues from income taxes has become notably higher since the income tax rates were increased under Public Act 96-1496, effective January 13, 2011. The rate increase was enacted in response to serious fiscal problems following the national recession in 2007-2009.

The income tax increase as passed in P.A. 96-1496 was designed as temporary, with steps down in the tax rates in 2015 and 2025. While the majority of the additional revenues from the higher tax rate has been directed to the General Funds, it should be noted that a portion of the rate, beginning in fiscal year 2015, is scheduled to be deposited into funds pledged solely to education and human services spending.

Since the General Funds are heavily dependent on income tax revenues, the steps down in the income tax rate will lead to a significant reduction in revenues coming into the state, leading the state off of a revenue "cliff." According to recent estimates by the Commission on Government Forecasting and Accountability (CoGFA), in fiscal year 2014 the additional General Funds revenues attributable to the higher income tax rates will total $7.762 billion. In fiscal year 2015, this revenue is estimated to fall to approximately $5.827 billion (a $1.9 billion decrease) and to $2.934 billion in fiscal year 2016 (an additional reduction of $2.9 billion).

The cumulative reduction in income tax receipts of approximately $4.8 billion is a cut to Illinois' revenues of approximately 13 percent. This level of revenue decline, at the same time the state has continued spending pressures in the areas of education, health care, human services and pensions, will be very difficult to absorb. But this statutorily mandated change in tax rates may not be the only item that affects revenue collections in the near-term. The state's tax base is intrinsically linked with the economy.

Illinois' Income Tax Rates

From	To	Individual Income Tax Rate	Corporate Income Tax Rate
July 1, 1969	January 1, 1983	2.50%	4.00%
January 1, 1983	July 1, 1984	3.00%	4.80%
July 1, 1984	January 1, 1989	2.50%	4.00%
January 1, 1989	January 1, 2011	3.00%	4.80%
January 1, 2011	January 1, 2015	5.00%	7.00%
January 1, 2015	January 1, 2025	3.75%	5.25%
January 1, 2025		3.25%	4.80%

Note: Rate changes for 2015 and 2025 are based on current law.

THE ECONOMY AND STATE TAX REVENUES

Recession Dates (1969 - current)

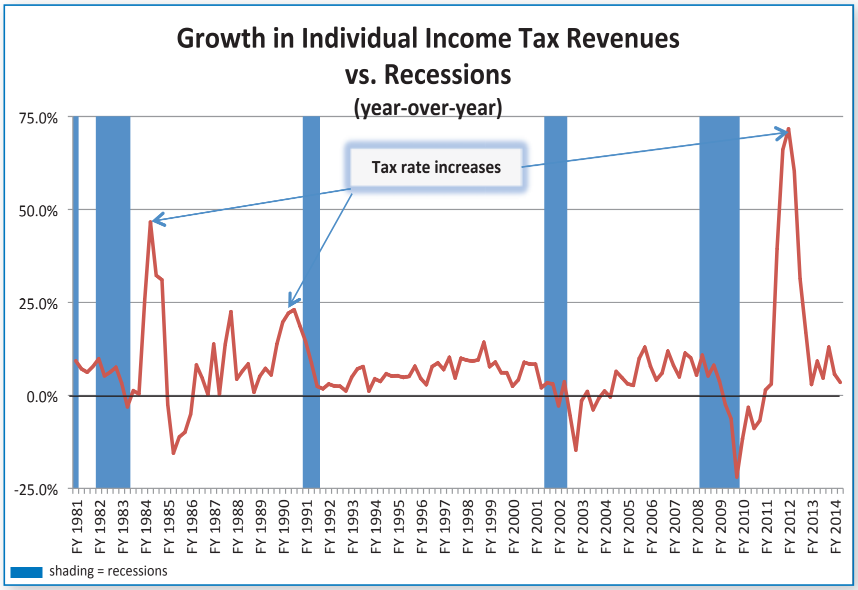
Begin Date	End Date	Duration of Recession (months)	Length of Expansion Prior to this Recession (months)
December 1969	November 1970	11	106
November 1973	March 1975	16	36
January 1980	July 1980	6	58
July 1981	November 1982	16	12
July 1990	March 1991	8	92
March 2001	November 2001	8	120
December 2007	June 2009	18	73

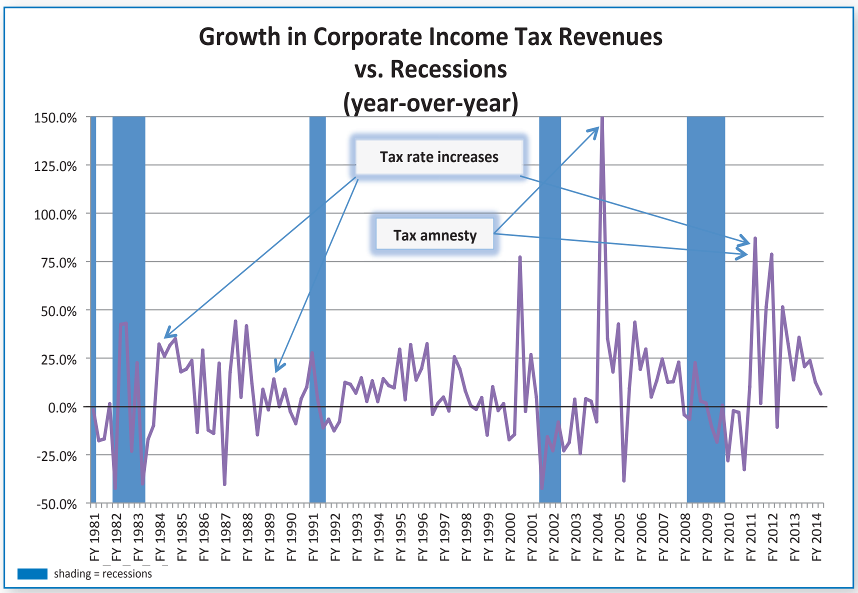
Source: National Bureau of Economic Research

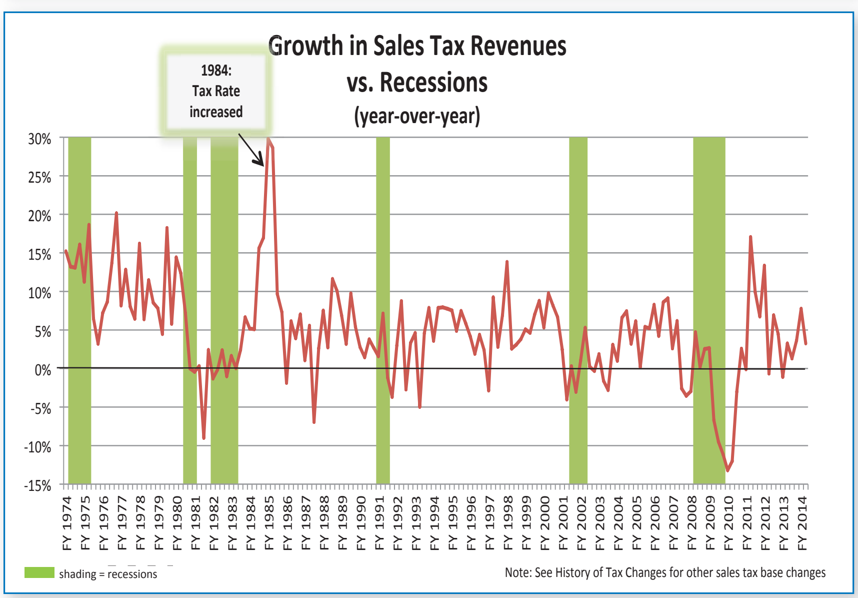
The business cycle and inflation have an impact on income and sales taxes. Inflation affects income and sales taxes because increases in the prices of goods and services eventually impact cost-of-living adjustments to wages. Changes in the business cycle from periods of economic growth to recession will increase or decrease the growth rates in these tax sources. As the economy expands, higher employment increases personal income and increases consumption. Increased sales of goods and services leads to growth in corporate profits followed by increased employment. During a recession, the opposite occurs. Decreases in consumption result in lower profits followed by reduced employment and declines in personal income.

As expected, cash receipts from state revenue sources exhibit an overall increasing trend since the imposition of the income tax began in fiscal year 1970. The accompanying charts illustrate growth in revenues through fiscal year 2014. During this period, the United States experienced seven recessions.

— continued on next page







Looking at the charts plotting individual income, corporate income and sales tax growth rates over the years, it is apparent the years with recessions had an impact. It should be noted that the income tax growth rates charted were based on gross income tax revenues, in order to eliminate the impact on General Funds receipts from the changes to the percent allocated to the Refund Fund, while sales tax data in the chart is limited to General Funds revenues. Also, tax amnesty programs were implemented in fiscal years 2004 and 2011 which impacted the data.

The spikes in the individual income tax chart were due to temporary increases in the income tax rates in 1983, 1989, and 2011 (see timeline of tax changes on p. 8). Corporate profits fluctuations tend to be more extreme than changes in the economy as a whole which contributes to the volatility of corporate income tax revenues. Besides the years with temporary increases in income tax rates, several additional factors have impacted corporate income tax revenues. Over the years, there have been numerous tax exemptions implemented which affect tax revenues. Prior to 2011, net operating loss allowances let businesses write off recession-era losses.

Looking at the timeline, the sales tax on food and drugs was reduced in 1980 and 1981 and eliminated in 1984 when the state tax rate was increased from 4 percent to 5 percent. The exemption of food and drugs from the state's sales tax base eliminated a stabilizing factor as consumers will delay or cut back on all other purchases before reducing the necessities. Sales taxes were also impacted by tax exemptions over the years including sales tax holidays in 2000 (on motor fuels) and 2010 (on clothing items and school supplies). In addition, sales tax collections were accelerated in fiscal years 1976 and 1992.

The most recent recession was the longest and most severe since the Great Depression and encompassed half of fiscal year 2008 and all of fiscal year 2009. The economic data for fiscal year 2009 was very depressed; wage and salary disbursements fell 1.9 percent, before-tax corporate profits declined 25.0 percent, retail sales decreased 7.5 percent, and employment in Illinois decreased by almost 166,000 jobs. Illinois tends to lag the nation in recovering from a recession. For example, in fiscal year 2010 employment fell by an additional 216,000 jobs.

— continued on next page

Taking a look at revenue collections during that recession, it is clear that Illinois' economy-driven tax revenues dropped off sharply. Income tax deposits into the General Funds during fiscal year 2009 and 2010 fell approximately 10 percent each year, while General Funds sales tax deposits dropped 6.1 percent and 6.9 percent in fiscal years 2009 and 2010 respectively. These revenue drops translated into a significant cash crunch for state finances, a crunch that Illinois is still struggling with today.

A POSSIBLE 2ND CLIFF?

Three years after Illinois raised individual and corporate tax rates, and more than four years since the official end of the last recession, the state continues to suffer through substantial bill backlogs and payment delays. While a strong revenue performance in the spring of 2013 reduced the General Funds budgetary deficit to "only" $3.988 billion, it was the fifth consecutive year of General Funds budgetary deficits exceeding $3.0 billion.

Highlights of State Tax and Revenue Changes, 1970 - 2014*

Major Taxes		Other Sources
	1970	
FY1970: Income tax imposed for first time		1974: State Lottery begins operations
1980: Sales tax on food and drugs reduced 1%	1980	1980: Vehicle use tax enacted at $30/vehicle, with vehicles over 5 years old later exempted
1981: Sales tax on food and drugs reduced additional 1%		
1983: Individual income increased to 3% and corporate increased to 4.8% temporarily until July 1984		1983: Lottery adds Lotto game
1984: Sales tax increased from 4% to 5% remaining tax on food and drugs removed		
		1985: Cigarette tax increased from 12 cents to 20 cents per pack, vehicle use tax changed to 5% of selling price for vehicles up to 10 years old
1986: Public utility tax changes with electric and gas based on lesser of 5% or usage and telecomm tax expanded to new services		
		1988: Vehicle use tax changed to rate based on age and selling price
1989: Individual income increased to 3% and corporate increased to 4.8% temporarily		1989: Cigarette tax increased to 30 cents/pack
1990: Sales tax rate increased from 5% to 6.25% with state portion remaining 5% and 1.25% to local governments	1990	1990: Riverboat wagering tax enacted, first boats operational in 1991
		1992: First Cook County Intergovernmental Transfer payment agreement
1993:Temporary income tax increase made permanent		1993: Cigarette tax increased to 44 cents/pack
1998: Telecommunications tax rate increased from 5% to 7% and electric tax replaced with new excise tax		1998: Cigarette tax increased to 58 cents/pack, riverboat wagering tax changed from flat rate to graduated rate structure
		1998: New insurance taxes imposed to replace unconstitutional earlier version
		1999: Liquor tax rates increased, motor vehicle license fees increased
	2000	
		2002: Cigarette tax increased to 98 cents/pack, riverboat tax rates increased
		2003: Riverboat wagering tax expanded for 2 years, commercial distribution fee added for commercial vehicles, decouple from federal estate tax changes
		2005: Expanded riverboat wagering tax ends but revenues held harmless
		2009: Liquor tax rates increased, motor vehicle and drivers license fees increased, video gaming legalized
	2010	2010: Lottery offers Powerball game
2011: Individual income increased to 5% and corporate increased to 7.0% temporarily with individual scheduled to drop to 3.75% in January 2015 and 3.25% in January 2025 and corporate will drop to 5.25% and 4.8% respectively		2011: Lottery is privatized with transfers to the Common School Fund the same as FY 2009 adjusted for inflation with the remainder going to the Capital Projects Fund
		2012: Cigarette tax increased to $1.98 /pack, video gaming became operational
		2013: Motor vehicle license fees increased

*Highlights focus on changes that affected the General Funds: most changes to taxes for other funds and specific Lottery games are omitted.

At the same time that the state is looking ahead to a scheduled drop in income tax rates, the country is inevitably moving closer to the next economic contraction. According to the National Bureau of Economic Research, in the post-World War II era, the average length of an economic expansion is just under five years – and the country will be reaching 60 months of expansion this summer.

While there do not appear to be strong indicators of another recession yet - and the sluggishness of the current expansion may enable it to extend beyond historical averages - the window during which Illinois can address its financial position in an expanding economy may be closing. ■

Where Does Your Money Go?

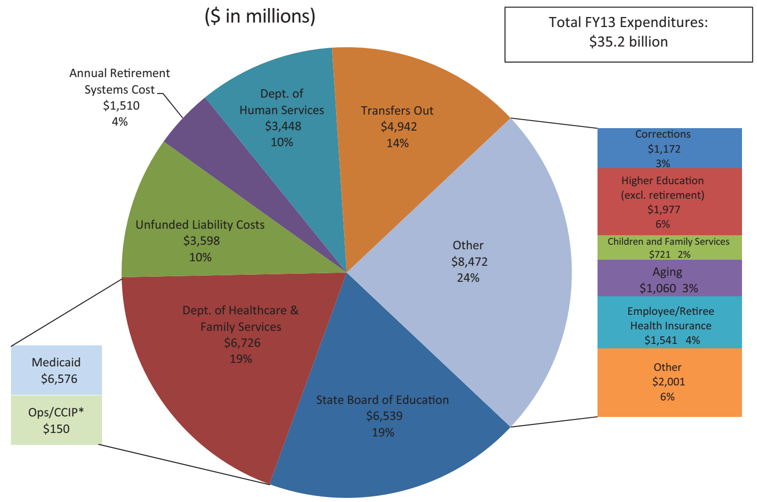
FY 2013 GENERAL FUNDS SPENDING

With the revenue cliff the State of Illinois is facing, as detailed in the cover story, some policymakers are making the case to cut the state budget rather than looking at increasing revenues. To achieve adequate savings to balance the budget, lawmakers interested in cutting must look closely at where the bulk of the state's money is expended. Approximately three-fourths of the state's General Funds budget is spent by three agencies, retirement system payments, and transfers to other state funds (primarily for debt service and local governments).

In fiscal year 2013, the state expended $35.2 billion from the General Funds, the largest of the state's fund groups (and usually the funds discussed when analyzing the state's budget). The pie chart to the right illustrates where that money was spent. In reviewing state expenditures, it's important to note that the two major categories of state government expenditures are operations, and awards and grants.

FY 2013 GENERAL FUNDS EXPENDITURES

($ in millions)

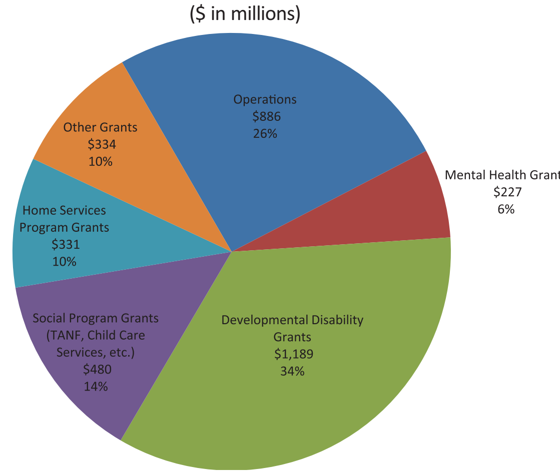


*Community College Insurance Program

The operations category includes the costs of running state government on a daily basis. It encompasses salaries paid to employees; payments by the state for its share of contributions to employee retirement systems, federal Social Security and Medicare taxes, and employee medical costs; payments for items necessary for agency operations, such as postage, office supplies, and telecommunications equipment; equipment; and official employee travel.

DEPARTMENT OF HUMAN SERVICES GENERAL FUNDS EXPENDITURES FY 2013

($ in millions)



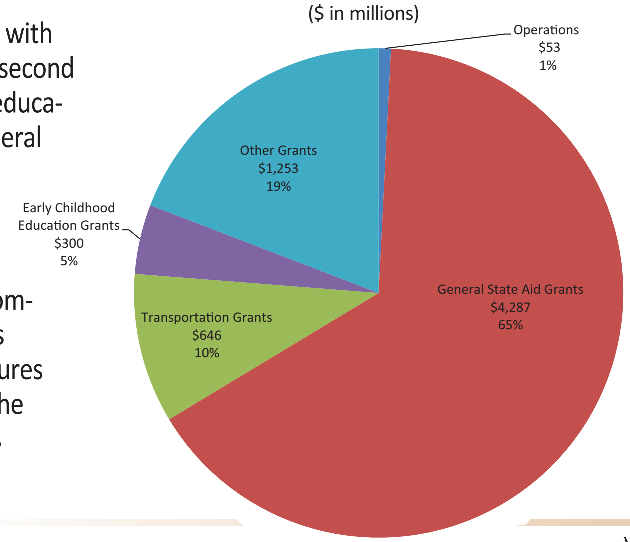
Awards and grants, on the other hand, is spending on state programs, such as Medicaid, child abuse prevention and foster care programs, General State Aid for schools, and services for the developmentally disabled and mentally impaired.

Looking at how the state allocates its revenues, the chart illustrates that the Department of Healthcare and Family Services is the highest spending state agency. It spent $6.726 billion, or 19 percent of total state General Funds expenditures in fiscal year 2013. As illustrated in the chart, the vast majority ($6.576 billion or 98 percent) of the agency's expenditures were grant spending for the Medicaid program for health insurance for lower income individuals.

The State Board of Education (SBoE) has the second largest slice of the pie, with $6.539 billion, or 19 percent, of total state General Funds expenditures. A second pie chart breaks down the state's spending on elementary and secondary education. Nearly $4.3 billion, or 65 percent, of SBoE's expenditures went to General State Aid. Thirty-four percent of the remaining expenditures went to other grant programs, while just less than one percent of expenditures was for the agency's operations.

STATE BOARD OF EDUCATION GENERAL FUNDS EXPENDITURES FY 2013

($ in millions)



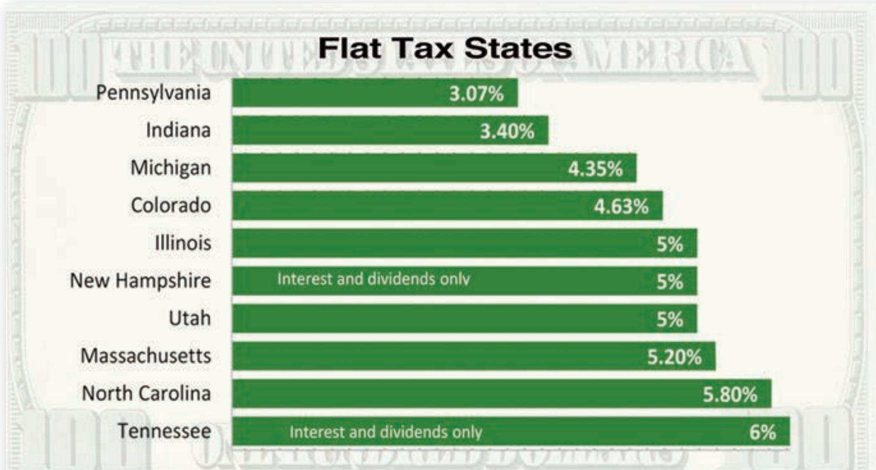
The Department of Human Services (DHS) expenditures of $3.4 billion encompassed 10 percent of the state's expenditures. Another pie chart illustrates where DHS' appropriations were spent. While 74 percent of DHS' expenditures were for various grant programs, approximately 26 percent was spent on the agency's operations – primarily the costs of staffing and running the state's mental health facilities.

— *continued on page 11*

Flat vs. Graduated Income Tax

The Illinois Constitution says that the state income tax must be at a flat rate. That rate for individuals was 3 percent from 1993 to 2011, when it was raised to 5 percent in an effort to make headway against the state's growing debt. But despite the increased revenue, the past two years have not seen much improvement in the state's fiscal condition. Additionally, most of the new revenue from the increase will disappear on January 1, 2015 when the rate is scheduled to decrease to 3.75 percent.

This has led some lawmakers and others to discuss a complete restructuring of the state's income tax system—namely, instituting a graduated income tax instead of a flat tax. Under a graduated tax, people with higher income pay higher rates. Proponents of a graduated tax say that it will actually reduce tax bills for lower and middle income taxpayers, while those who can afford it will pay more. They also contend that it will bring in more revenue for the state. Opponents say that a graduated tax is unfair because it does not treat all taxpayers equally, and it punishes high earners for their success. They also say that

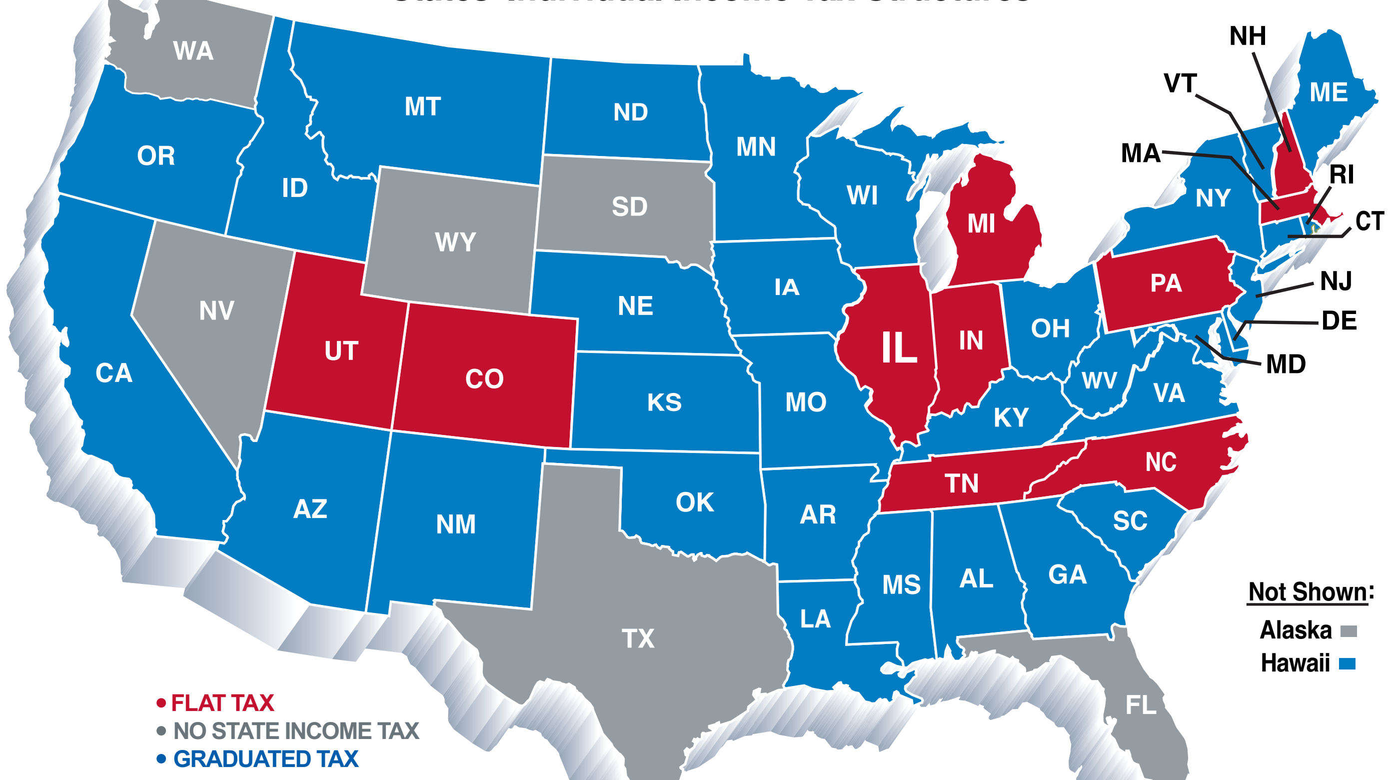


taxes will inevitably increase on middle-class taxpayers and small businesses, and businesses will leave the state.

At least two House Joint Resolutions and four Senate Joint Resolutions were introduced to put a proposed constitu-

— continued on next page

States' Individual Income Tax Structures



SOURCE: Federation of Tax Administrators and Tax Foundation
(Data is as of January 1, 2014)

tional amendment on the November 2014 general election ballot to allow a graduated income tax, but none of them passed before the deadline. They had a high bar for passage--both chambers of the legislature would have had to pass one of the resolutions by a 3/5 vote to get the measure on the ballot, and the ballot question would need to be approved by either 3/5 of those voting on it or a majority of those voting in the election for the change to take effect. On the other hand, House Resolution 241, with 48 sponsors, states the sponsors' belief that the Illinois Constitution should not be amended to permit a graduated income tax. None of the resolutions in favor of amending the state Constitution included any proposed rate structures. One of them, House Joint Resolution Constitutional Amendment 33, lost in a March 27 vote in the House Revenue and Finance Committee. The other House resolution and three of the Senate resolutions did not receive votes. The fourth Senate resolution made it to the order of Third Reading in the Senate.

Additionally, House Joint Resolution Constitutional Amendment 51, introduced on March 20 by Speaker Madigan, proposed placing on the November ballot a constitutional amendment to impose a 3 percent tax on income greater than $1 million. The tax rate on all other income would remain the same. All revenue collected from the 3 percent tax would be distributed to school districts on a per-pupil basis. The resolution passed the Revenue and Finance Committee on March 27, but no further action was taken by the deadline.

Illinois is one of 10 states with a flat individual income tax. (Two of those states, New Hampshire and Tennessee, tax only interest and dividends.) Seven states have no state income tax. The remaining 33 states have graduated rates. Those states vary widely in how they structure their rates. The number of brackets range from 2 in Kansas to 12 in Hawaii. Maine and South Carolina have the lowest bracket rate of 0 percent (they do not tax income up to $5,200 in Maine and $2,880 in South Carolina), and California has the highest at 13.3 percent, which applies to income over $1 million. States also vary widely in their standard deductions and personal exemptions, which can make a big difference in the amount of tax paid. The accompanying chart details the variations in each state, and they are summarized in the map and graph. ■

State Individual Income Tax Rates, Tax Year 2014

	Tax Rate Range		# of	Income Brackets		Standard	Personal Exemptions	
State	Low	High	Brackets	Low	High	Deduction	Per Filer	Per Dependent
Alabama	2%	5%	3	$500	$3,001	$2,500 (1)	$1,500	$1,000 (1)
Alaska	No state individual income tax							
Arizona	2.59%	4.54%	5	$10,000	$150,001	$4,945	$2,100	$2,300
Arkansas	1%	7%	6	$4,199	$34,600	$2,000	$26 (2)	$26 (2)
California	1%	13.30%	10	$7,582	$1,000,001	$3,906	$106 (1)(2)	$326 (1)(2)
Colorado	4.63%	4.63%	-	-	-	(3)	(3)	(3)
Connecticut	3%	6.70%	6	$10,000	$250,001	-	$14,000 (1)(4)	-
Delaware	2.20%	6.60%	6	$2,000	$60,001	$3,250	$110 (2)	$110 (2)
Florida	No state individual income tax							
Georgia	1%	6%	6	$750	$7,001	$2,300	$2,700	$3,000
Hawaii	1.40%	11%	12	$2,400	$200,001	$2,200	$1,144	$1,144
Idaho	1.60%	7.40%	7	$1,408	$10,568	(3)	(3)	(3)
Illinois	5%	5%	-	-	-	-	$2,125	$2,125
Indiana	3.40%	3.40%	-	-	-	-	$1,000	$2,500
Iowa	0.36%	8.98%	9	$1,515	$68,176	$1,900	$40 (2)	$40 (2)
Kansas	2.70%	4.80%	2	$15,000	$15,000	$3,000	$2,250	$2,250
Kentucky	2%	6%	6	$3,000	$75,001	$2,360	$20 (2)	$20 (2)
Louisiana	2%	6%	3	$12,500	$50,001	-	$4,500	$1,000
Maine	0%	7.95%	3	$5,200	$20,901	$6,100	$3,900	$3,900
Maryland	2%	5.75%	8	$1,000	$250,001	$2,000	$3,200 (1)	$3,200 (1)
Massachusetts	5.20%	5.20%	-	-	-	-	$4,400	$1,000
Michigan	4.25%	4.25%	-	-	-	-	$3,950	$3,950
Minnesota	5.35%	9.85%	4	$24,680	$152,541	(3)	(3)	(3)
Mississippi	3%	5%	3	$5,000	$10,001	$2,300	$6,000	$1,500
Missouri	1.50%	6%	10	$1,000	$9,001	$6,200	$2,100	$1,200
Montana	1%	6.90%	7	$2,800	$16,701	$4,270 (5)	$2,280	$2,280
Nebraska	2.46%	6.84%	4	$3,000	$29,001	$6,200	$126 (2)	$126 (2)
Nevada	No state individual income tax							
New Hampshire	5%	5%	-	-	-	-	$2,400	-
New Jersey	1.40%	8.97%	6	$20,000	$500,001	-	$1,000	$1,500
New Mexico	1.70%	4.90%	4	$5,500	$16,001	(3)	(3)	(3)
New York	4%	8.82%	8	$8,200	$1,029,251	$7,700	-	$1,000
North Carolina	5.80%	5.80%	-	-	-	$7,500	-	-
North Dakota	1.22%	3.22%	5	$36,900	$405,101	(3)	(3)	(3)
Ohio	0.534%	5.392%	9	$5,200	$208,501	-	$1,700	$1,700
Oklahoma	0.50%	5.25%	7	$1,000	$8,701	(3)	$1,000	$1,000
Oregon	5%	9.90%	4	$3,300	$125,001	$2,025	$188 (2)	$188 (2)
Pennsylvania	3.07%	3.07%	-	-	-	-	-	-
Rhode Island	3.75%	5.99%	3	$59,600	$135,501	$8,100 (1)	$3,800 (1)	$3,800 (1)
South Carolina	0%	7%	6	$2,880	$14,401	(3)	(3)	(3)
South Dakota	No state individual income tax							
Tennessee	6%	6%	-	-	-	-	$1,250	-
Texas	No state individual income tax							
Utah	5%	5%	-	-	-	(3)	(3)	(3)
Vermont	3.55%	8.95%	5	$36,900	$405,101	(3)	(3)	(3)
Virginia	2%	5.75%	4	$3,000	$17,001	$3,000	$930	$930
Washington	No state individual income tax							
West Virginia	3%	6.50%	5	$10,000	$60,001	-	$2,000	$2,000
Wisconsin	4.40%	7.65%	4	$10,910	$240,191	$9,930 (1)	$700	$700
Wyoming	No state individual income tax							

Note: Data is for single filers. States' income tax provisions are very complex; some details may be omitted.
Some information is for tax year 2013 because 2014 data has not yet been released.
Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming have no state income tax.
New Hampshire and Tennessee tax only interest and dividend income.

Sources: Federation of Tax Administrators, "State Individual Income Taxes" (as of January 1, 2014);
Tax Foundation, "State Individual Income Tax Rates, As Of January 1, 2014";
states' revenue department websites.

(1) Subject to phaseout for AGIs above a certain amount.
(2) The personal exemption is a tax credit instead of a deduction.
(3) Tied to the amounts in the federal Internal Revenue Code.
(4) Taxpayers also receive a personal tax credit based on income.
(5) Equal to 20% of AGI, subject to annually adjusted minimums and maximums.

WHERE DOES YOUR MONEY GO? concluded

Approximately $5.1 billion of the state's General Funds expenditures were for payments to the state's retirement systems, and another $4.9 billion was spent as a transfer out to another state fund. The transfers out were primarily for debt service on state issued bonds and revenue sharing with local governments.

Other large agencies are illustrated along the right of the first pie chart, including $2.0 billion for higher education (e.g. payments to state universities, community colleges and financial aid), $1.2 billion for the Department of Corrections and $1.5 billion for employee and retiree health insurance costs. ■

The New World of Taxing E-Commerce

Making purchases over the Internet is now a common part of many people's lives. In fact, the U.S. Census Bureau estimated total e-commerce sales in 2012 at $225.5 billion, about 5.2 percent of total sales and an increase of 15.8 percent from 2011. While the rise in e-commerce has opened up new possibilities for many businesses, states have seen a loss in sales tax revenue as people buy less from brick-and-mortar stores and more through largely untaxed "remote sales."

FEDERAL EFFORTS

Two long-standing U.S. Supreme Court decisions say that states do not have the authority under the U.S. Constitution to compel collection of sales taxes from sellers who do not have a physical presence in the state. In other words, a company physically located in New York that sells goods over the Internet to someone in Illinois cannot be required to collect Illinois sales tax on those sales (although the buyer is supposed to pay it to the state). Congress would need to explicitly grant states the authority to impose their sales taxes on remote sales in order to provide a comprehensive solution to the problem. One of the most recent efforts to do so, called the Marketplace Fairness Act of 2013, passed the U.S. Senate on May 6, 2013 and is currently in the House of Representatives. Under the bill, states that agree to simplify their state sales tax laws will have authority to require all sellers, regardless of physical presence in the state, to collect and remit sales taxes to the state. States would have two options for simplifying their sales tax laws: (1) become a member of the Streamlined Sales and Use Tax Agreement, or (2) implement some basic simplifications, including designating a single state agency to handle sales tax registrations, filings, and audits; establishing a uniform sales tax base for use throughout the state; using destination sourcing to determine sales tax rates for out-of-state purchases (for example, a purchase made by a customer in Illinois from a retailer in New York is taxed at the Illinois rate, and the tax is remitted to Illinois); providing free software to remote sellers for managing sales tax compliance; and notifying retailers in advance of any rate changes. The bill would apply only to remote sellers with gross annual U.S. remote sales receipts in the preceding calendar year over $1 million.

STREAMLINED SALES TAX STATE STATUS, AS OF JANUARY 1, 2014

Full Member States	Associate Member State	Project State - Non Advisory*
Arkansas	Tennessee	Pennsylvania
Georgia		
Indiana	**Advisory States**	**Non-Participating State***
Iowa	Alabama	Colorado
Kansas	Arizona	
Kentucky	California	**No Sales Tax States**
Michigan	Connecticut	Alaska
Minnesota	Florida	Delaware
Nebraska	Hawaii	Montana
Nevada	Idaho	New Hampshire
New Jersey	Illinois	Oregon
North Carolina	Louisiana	
North Dakota	Maine	* Colorado does not participate. Pennsylvania sometimes comes to meetings, but does not participate further.
Ohio	Maryland	
Oklahoma	Massachusetts	
Rhode Island	Mississippi	
South Dakota	Missouri	
Utah	New Mexico	
Vermont	New York	
Washington	South Carolina	
West Virginia	Texas	
Wisconsin	Virginia	
Wyoming		

Source: Streamlined Sales Tax Project Website.

STATE EFFORTS

The Streamlined Sales and Use Tax Agreement, referenced in the federal bill, is a voluntary effort by states to reduce the complexity of states' sales tax laws and make Congress more inclined to require remote sellers to collect sales taxes. States that join must change their sales tax laws to conform to the Agreement, including adopting uniform state and local tax bases and tax base definitions; simplifying state and local tax rates, exemptions, and returns; and adopting uniform sourcing rules. Once a state changes its laws to the satisfaction of the governing board, it becomes a Full Member state. States that are deemed to be mostly in compliance with the Agreement are Associate Member states. Companies are encouraged to register with the governing board. If they do, they are required to collect sales tax for all Full Member states and may choose to collect it for Associate Member states. As shown in the accompanying chart, there are currently 23 Full Member states; Tennessee is the only Associate Member state. Most of the remaining states, including Illinois, are Advisory States, meaning that they have taken some steps toward compliance.

Illinois enacted Public Act 92-221 in 2001 to authorize the Department of Revenue to work with other states to establish the standards for a streamlined sales tax system, and to enter into a multistate streamlined sales tax agreement. Most attempts to pass additional laws to modify Illinois' sales tax code to comply with the Agreement have been held up by concerns about how the changes would affect retailers and taxing districts.

— continued on next page

However, the change made by Public Act 96-34 in 2009 to tax candy, grooming and hygiene products, and soft drinks at 6.25 percent instead of 1 percent was a step toward more compliance with the Agreement.

The Streamlined Sales and Use Tax Agreement is voluntary for sellers to participate. Some states have tried to take a more forceful role in collecting taxes for remote sales by enacting so-called “Amazon laws.” These laws expand the definition of a physical presence by requiring that large online retailers collect sales tax if they have click-through advertisements on state-based websites, known as affiliate relationships. The laws were largely seen as targeting Amazon.com, which fought back by dropping its affiliates in several states that enacted the laws, including Illinois. Amazon challenged a similar New York law in state court, and lost; the U.S. Supreme Court declined to hear the appeal. Conversely, in October 2013 the Illinois Supreme Court struck down Illinois’ affiliate law, ruling that it conflicted with a federal law that temporarily blocks new taxes on online retailers or Internet providers. At least 14 other states have affiliate laws: Arkansas, California, Colorado, Connecticut, Georgia, Minnesota, New York, North Carolina, Oklahoma, Rhode Island, South Dakota, Tennessee, Texas, and Vermont.

REVENUE LOSSES

Researchers at the University of Tennessee estimated in 2009 that states and local governments would lose $11.4 billion to $12.7 billion in 2012 through non-taxed e-commerce. Illinois’ portion of that was about $507 million to $563 million. The Illinois Department of Revenue has also estimated how much Illinois loses from untaxed Internet sales, with the most recent update in June 2011. They estimated that by calendar year 2013, Illinois would lose $212 million on unpaid use tax on online sales (use tax is the tax that buyers are supposed to pay the state if they are not charged sales tax by a seller). The National Conference of State Legislatures has developed estimates for state losses from all untaxed sales, including Internet, catalog, and phone sales. Estimated total U.S. losses in 2012 were $23.3 billion, with $1.1 billion of that lost by Illinois. Although it is unlikely that all of that will ever be collected, even a portion of it could be helpful to a financially strapped state like Illinois. ■

KEEPING STATE MONEY SECURE: REDUCING FRAUD AND WASTE IN MEDICAID

Policymakers tend to focus on increasing revenues or cutting costs to make budgets work, but protecting state coffers from fraud and waste is an important component of safeguarding the state budget as well. One area that many states, including Illinois, have focused is making sure that only eligible residents are receiving services in the Medicaid program. The U.S. Department of Health and Human Services estimated that nationwide about $13 billion was lost in fiscal year 2013 through Medicaid fraud and abuse, although the exact number is unknown.

In June 2012, the Save Medicaid Access and Resources Together (SMART) Act (P.A. 97-689) was enacted to address fraud, waste, and abuse in the state’s Medicaid program. Among many things, the SMART Act aims to address fraud before it happens through better screening of clients and providers before enrollment; improved monitoring of billing practices; improved data sharing among agencies to allow better verification of client and provider eligibility; and expansion of the Illinois Department of Healthcare and Family Services’ Office of Inspector General (OIG) auditing capabilities. A recent SMART Act implementation report shows that actual savings from the Act in fiscal year 2013 was a little over $1 billion, compared to an original savings target of $1.6 billion.

The OIG is responsible for overseeing the integrity of the state’s Medicaid program. According to its most recent annual report, during calendar year 2012 the OIG realized a cost savings and avoidance of about $89.0 million through prevention (58 percent) and enforcement (42 percent) initiatives.

The report says that the largest prevention savings, $16.0 million, came from Long Term Care--Asset Discovery Investigations, with a stated return on investment of $7.26 per $1 spent. The program targets error-prone long term care applications, with the goal of keeping ineligible people from receiving long term care benefits. Another large cost saving prevention activity was the Fraud Prevention Investigations program. It investigates suspicious public assistance applications, and saved a reported $8.6 million in 2012 for all the state’s public assistance programs.

On the enforcement side, the OIG reported that Medical Provider Audits saved $34.9 million in 2012. The OIG audits medical providers whose billing patterns are suspicious. Their work was augmented by a recently-installed predictive modeling system, which uses statistical techniques to identify providers and recipients engaged in fraud. ■

Tax Breaks Help Taxpayers, But Reduce State Revenue

Three Large Tax Expenditures for Individuals, FY 2013

Amount (millions)	*Expenditure*	*Applied Against*
$2,233	Retirement and Social Security Deductions	Individual Income Tax
1,110	Standard Deduction	Individual Income Tax
162	Earned Income Tax Credit	Individual Income Tax

Five Large Tax Expenditures for Businesses, FY 2013

Amount (millions)	*Expenditure*	*Applied Against*
$360	Foreign Dividend Subtraction	Corporate Income Tax
267	Farm Chemical Exemption	Sales Tax
204	Manufacturing Machinery Exemption	Sales Tax
125	Retailer's Discount	Sales Tax
114	Non Motor Vehicle Use	Motor Fuel Tax

Some argue that tax expenditures (such as tax exemptions or credits) are considered helpful incentives, while others say they are unnecessary giveaways. According to the Illinois Comptroller's fiscal [2013 Tax Expenditure Report], state revenues were reduced by $8.9 billion that year through various tax expenditures. That is money that could have been used for other state purposes. On the other hand, individuals and families benefitted from 66 percent of those tax expenditures, through breaks such as the retirement income and Social Security deduction, the sales tax reduction for food, drugs, and medical appliances, and the standard deduction from the individual income tax. It could be argued that those are the people government is intended to help, and that money people don't spend in taxes is money they spend to bolster the economy. The tension between the two schools of thought on tax expenditures is not likely to be resolved anytime soon, but it is helpful for lawmakers and the public to be aware of the types of state tax expenditures and where they go.

INDIVIDUAL INCOME TAXES

The largest tax expenditure, estimated at $2.233 billion in fiscal year 2013, is the individual income tax deduction for retirement and Social Security income. That deduction applies to all retirement income, including Social Security and public and private pensions. Only two other states, Mississippi and Pennsylvania, exempt all three sources of income. Seven other states (Alaska, Florida, Nevada, South Dakota, Texas, Washington, and Wyoming) have no individual income tax. Most of the other states offer deductions for at least some types of retirement income, often limited based on taxpayer age or amount of retirement income. Illinois' cost for this tax expenditure has risen to almost 8 times its fiscal year 1993 cost of $284 million. The increase can be attributed to several factors: the growth in income that has become subject to federal tax, such as the increase in taxable social security income in 1994; the aging of the population; and the individual income tax rate increase from 3 percent to 5 percent that raised the value of all individual income tax expenditures.

The third largest tax expenditure was the standard deduction from the state individual income tax, which cost the state $1.110 billion in fiscal year 2013. Taxpayers benefitted from an increase in the standard deduction from $2,000 in tax year 2011 to $2,050 in 2012 and $2,100 in 2013; the deduction will be increased by an inflation adjustment each year after that. While the increases will make taxpayers happy, they will also increase the state's revenue loss from this tax expenditure.

Illinois also aided low-income taxpayers by raising the state Earned Income Tax Credit from 5 percent to 7.5 percent of the federal EITC in tax year 2012, and to 10 percent in later years. In fiscal year 2013, this credit reduced Illinois tax revenues by about $162 million. The accompanying table summarizes these three large tax expenditures.

SALES TAX

Illinois' sales tax rate is 6.25 percent, of which the state keeps 5 percent and local governments get 1.25 percent. However, food, drugs, and medical appliances are taxed at only 1 percent. This tax expenditure, the second-largest, reduced Illinois' tax revenues by about $1.644

—*continued on next page*

billion in fiscal year 2013. Five other states impose a reduced rate on food: Arkansas, Missouri, Tennessee, Utah, and Virginia. Thirty-two states completely exempt food from state sales tax. Five states fully tax food, but have credits or rebates for low-income households: Hawaii, Idaho, Kansas, Oklahoma, and South Dakota. Alabama and Mississippi have no tax breaks for food. The remaining five states have no sales tax: Alaska, Delaware, Montana, New Hampshire, and Oregon. Regarding prescription drugs, Illinois appears to be the only state that does not completely exempt them from the sales tax. However, only nine states exempt non-prescription drugs from sales tax.

It often takes tax laws some time to catch up with changes in the world and its economy. One way in which many states are struggling to adapt is in the taxation of the sales of services. Most state sales tax laws were enacted in the 1930s, before services were a large part of the economy. But services have grown exponentially since then; according to the U.S. Department of Commerce's Bureau of Economic Analysis, in 2013 about 66 percent of all consumer spending was on services. As a result, states have made efforts toward taxing services, although they are usually met with fierce opposition from the business groups that would be affected by the taxes. Illinois' Commission on Government Forecasting and Accountability (CGFA) reported that a 2007 survey by the Federation of Tax Administrators found that the average number of services taxed by states is 56, with Hawaii the highest at 160 and Oregon the least at none. Illinois was found to tax 17 service categories, well below the average. CGFA produced two estimates for how much annual revenue could be generated by taxing services. The first, with all potential services taxed (minus those deemed to be already taxed), was $8.45 billion for the state and $2.11 billion for local governments. The majority of that would come from taxation of professional services; business services; finance, real estate, and insurance services; and construction services. The second estimate excluded taxation of business-to-business transactions, which traditionally are not taxed; it would result in $4 billion for the state and $1 billion for local governments.

BUSINESS TAXES

The Tax Expenditure Report also contains data on tax expenditures for businesses. The largest include the foreign dividend corporate income tax subtraction, farm chemical sales tax exemption, the manufacturing machinery sales tax exemption, the retailer's discount, and the exemption from the motor fuel tax for special fuel sold for use other than in motor vehicles. The accompanying table shows the amounts at which those expenditures impacted state revenues in fiscal year 2013.

Another business incentive, the Economic Development for a Growing Economy (EDGE) income tax credit, has been the focus of legislative and media attention in recent months as more and more companies request the incentive in return for staying in Illinois. Since some companies pay little corporate income tax, and thus would not be helped by an income tax credit, the state has allowed some of them to keep the income taxes they withhold from their employees. This practice, and the growing use of business incentives in general, has led some people to question what the state is getting in return and whether there is any appreciable benefit to Illinois' economy in exchange for the state revenue lost to those incentives.

The pull between the desire to help taxpayers and the need to increase state revenues makes tax expenditures an issue fraught with debate. While the tension will never be fully resolved, public awareness of tax expenditures and their costs and benefits allows lawmakers and the public to better evaluate the expenditures that exist and to knowledgeably decide whether to enact new ones. ■

FISCAL FOCUS

Fiscal Focus is one of the ways the Comptroller's Office strives to assist taxpayers and the people of Illinois. This report is designed to provide fiscal information of general interest.

Editorial Staff: Alexis Sturm, Sara Wojcicki Jimenez, Sarah Barlow, and Brad Hahn. Writers and Analysts: Alexis Sturm, Sarah Barlow, Bill Dracos, Stephanie Blair, Javier Cazares, Barton Lorimor, Aimee Ayers Mansfield. Production: Shelly Case, Susan Hansen, Frank Weitzel, Larry Olson, and Mark Lewis.

Fiscal Focus is published by Comptroller Judy Baar Topinka, 201 State House, Springfield, Illinois 62706. Questions or comments may be directed to (217)782-6000.

Web Address: **www.illinoiscomptroller.com**

In compliance with the Americans with Disabilities Act, this document may be requested in alternative formats by contacting the Office of the Comptroller at (217)782-6000 or calling the IOC Telecommunications Device for the Deaf (TDD) number, (217)782-1308, or by visiting the Illinois State Capitol Building, 201 State House, Springfield, Illinois.

The Illinois Office of the Comptroller is an equal opportunity employer and does not discriminate on the basis of race, color, religion, sex, marital status, national origin, ancestry, age or disability in employment or in the provision of any services, programs or activities.

Printed by Authority of the State of Illinois, 5/20/14, 825, Job 44160

Exploring Smaller State Revenue Sources

Illinois' General Funds get the largest share of revenue from the income and sales taxes, but the state has numerous other revenue sources, many of which have been targeted over the years to raise additional revenue to meet spending pressures. They support a wide range of programs, such as education, health care, capital projects, and regulatory oversight, in addition to general spending.

PUBLIC UTILITY TAXES

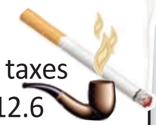
There are separate taxes on companies that sell electricity, telecommunications, and natural gas, all of which are passed on to customers. A tax on public utilities' electric revenue was originally set at 3 percent in 1937, but was eventually replaced by a tax based on kilowatt-hours sold. Electric tax revenue, which was about $405 million in fiscal year 2013, goes mostly to the General Revenue Fund (GRF). Three percent goes to the Public Utility Fund to help fund the Illinois Commerce Commission.

The natural gas tax and the telecommunications tax were both enacted in 1945 at 3 percent of gross revenues. The most recent change was in 1986, when the natural gas rate increased to the lesser of 5 percent of gross revenue or 2.4 cents per units of heat, with all receipts going to GRF. Natural gas tax receipts totaled $144 million in fiscal year 2013.

The telecommunications tax rose through the years to its current 7 percent rate, with proceeds going to the Common School Fund, GRF, and School Infrastructure Fund. This tax generated $573 million in fiscal year 2013, with $491 million going to the General Funds.

The intrastate gross revenue tax, paid by communications and gas companies to fund the Illinois Commerce Commission, was enacted in 1963 at 0.08 percent. The Commission was later authorized to charge up to 0.1 percent. About $6.5 million was collected in fiscal year 2013.

CIGARETTE AND OTHER TOBACCO TAXES



Revenues from cigarette and other tobacco taxes totaled $856 million in fiscal year 2013, up 12.6 percent from 2004. The cigarette tax was enacted in 1941 at 2 cents per pack and has changed 13 times over the years, climbing to $1.98 per pack currently. It supports education, health care, and GRF.

ESTATE TAXES

Illinois exempts the first $4 million of a decedent's taxable estate from estate tax; the tax on the rest is tied to the federal estate tax. Until 1983, Illinois also imposed an inheritance tax, but it was abolished. The estate tax raised $309 million in fiscal year 2013, with 94 percent going to the GRF and the rest to refund overpayments.

RIVERBOAT GAMBLING TAXES

Illinois has 10 riverboats, the maximum allowed by law. Wagering taxes, license fees, and part of an admissions tax are paid to the state by the riverboats. Those revenues, totaling $579 million in fiscal year 2013, have decreased 25.3 percent since 2004. Officials and commentators attribute the drop to many factors, including regional competition, the indoor smoking ban, and the economy in general. A large portion of the money is transferred to the Education Assistance Fund, with smaller amounts distributed to local governments where boats are docked, agencies that enforce gambling laws and treat problem gambling, and the horse racing industry. A 2009 tax on video gaming may help to replace some of the decreased riverboat gambling revenues; it brought in $24.5 million for the Capital Projects Fund in fiscal year 2013. Nearly $5 million went back to local governments that allow video gaming.

— continued on next page

INSURANCE TAXES

The Illinois Department of Insurance oversees a number of taxes on insurance companies, including a privilege tax on foreign companies; a fire marshal's tax on companies writing fire-related policies; and a surplus line producer's tax on brokers writing non-standard policies with companies not licensed in Illinois. Fiscal year 2013 revenue from insurance taxes and fees was $442 million. Most of the money goes to GRF, with some going to funds for insurance regulation and fire prevention.

Appropriated Funds Receipts From Selected Sources, FYs 2004 and 2013			
Source	FY 2004 Receipts (millions)	FY 2013 Receipts (millions)	% Change
Public Utility Taxes*	$1,576	$1,564	-0.8%
Lottery Tickets and Licenses	881	1,388	57.5%
Cigarette Taxes	760	856	12.6%
Riverboat Gambling Taxes and Fees	775	579	-25.3%
Insurance Taxes and Fees	466	442	-5.2%
Estate Taxes	222	309	39.2%
Liquor Taxes	127	280	120.5%
Corporation Franchise Taxes and Fees	169	213	26.0%
Totals	$4,976	$5,631	13.2%

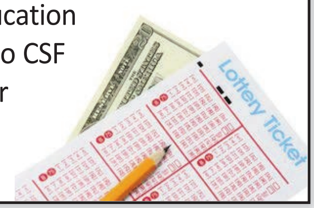
* Totals include receipts for some charges not described in the article, such as municipal taxes, wireless charges, and energy assistance charges.
Source: Comptroller's FY 2013 Traditional Budgetary Financial Report

CORPORATION FRANCHISE TAX

All corporations doing business in Illinois pay franchise taxes based on their paid-in capital (the amount paid to the corporation by initial buyers of shares), equaling 0.15 percent when they start doing business and when paid-in capital increases, and 0.1 percent annually. The tax and associated fees collected $213 million in fiscal year 2013, with 98 percent going to GRF and 2 percent for refunds.

LOTTERY

Lottery tickets and licenses brought in close to $1.4 billion in fiscal year 2013. Net revenue, after payments for prizes, agents' commissions, and operating expenses, goes first to the Common School Fund (CSF) in an amount equal to what was transferred there in fiscal year 2009, adjusted for inflation. The rest goes to the Capital Projects Fund. The lottery has been a fairly steady source of funds for education over the years; contributions to CSF were $570 million in fiscal year 2004 and $656 million in fiscal year 2013.



LIQUOR TAXES

Taxes on liquor were first enacted in 1934 at 2 cents per gallon for beer, 10 cents per gallon for wine with up to 14 percent alcohol, 25 cents per gallon for wine with more than 14 percent alcohol, and 50 cents per gallon for distilled liquor. Those rates have risen to 23.1 cents per gallon for beer and cider, $1.39 per gallon for wine, and $8.55 per gallon for distilled liquor. Revenue has increased 121 percent since 2004, from $127 million that year to $280 million in fiscal year 2013. Part of the reason for the huge jump in revenues was because policy makers increased the rates in 2009 to help pay for capital projects.

Funding With Fees: A Case Study

Although easy to overlook, fees are a huge source of state revenue. As reported in the Comptroller's fiscal year 2013 Fee Imposition Report, if the $8.526 billion in fee revenues were tracked as a single combined source, they would have been the fourth largest state revenue source that year, trailing only the state income taxes ($22.0 billion), federal aid ($16.3 billion), and the state sales taxes ($9.1 billion).

Most fee revenues are deposited into funds from which monies can be spent only for restricted purposes. Of the $8.526 billion in fee revenues collected in fiscal year 2013, $8.016 billion or 94 percent was deposited into a wide variety of these restricted funds. (The remaining $510 million was deposited into the state's General Funds.)

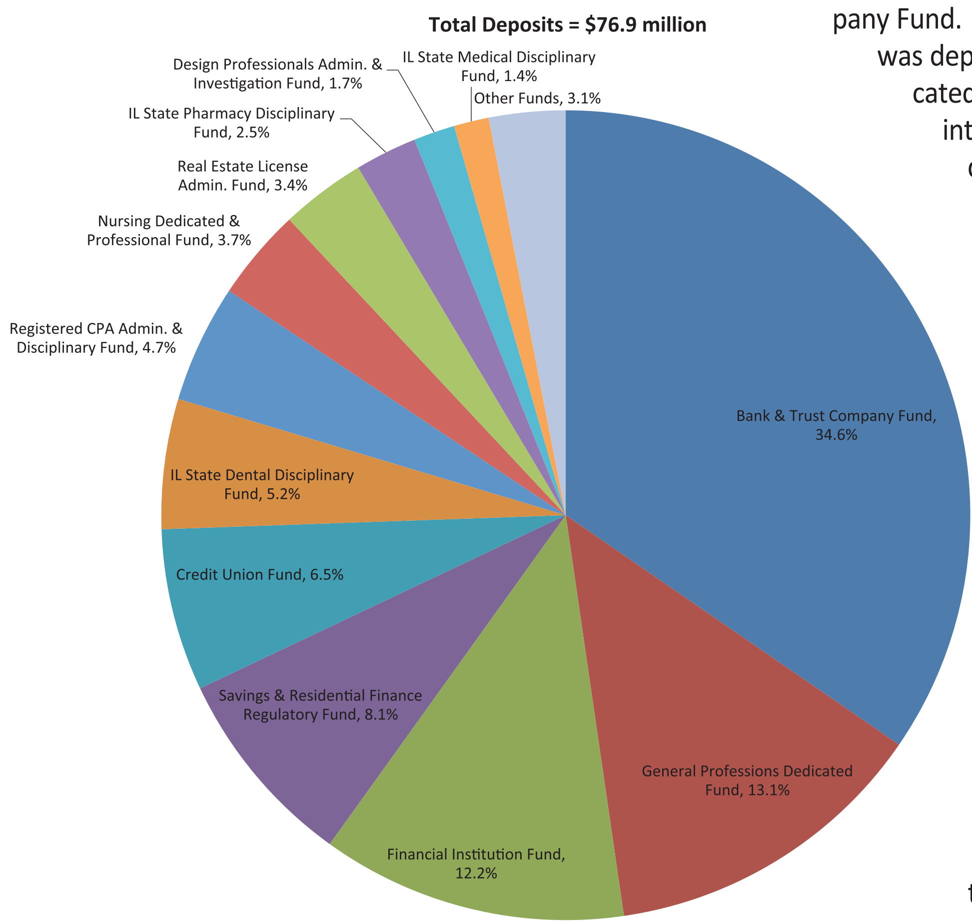
Agencies that collect those restricted-purpose fee revenues use them to fund their regulatory responsibilities, freeing up state General Funds money that would otherwise have to be used for that purpose. For example, the Illinois Department of Financial and Professional Regulation (DFPR) reported $76.9 million in fee revenues in fiscal year 2013—the 14th highest of all reporting agencies--paid mostly by persons obtaining professional licenses or paying associated fees or fines. Those revenues were deposited into various special state funds, to be used by DFPR to administer licensing and regulatory programs. As a result, DFPR is one of the state's agencies that is able to operate without any General Funds.

In fiscal year 2013, DFPR collected 104 fees, the second-highest of any reporting agency that year.

Most fees collected by DFPR go into dedicated funds from which DFPR pays for its licensing and regulatory responsibilities. As shown in the accompanying pie chart, the major portion of fee revenue generated by the DFPR ($26.6 million or approximately 35 percent) was collected from banks and deposited into the Bank and Trust Company Fund. Another $10.1 million (about 13 percent) was deposited into the General Professions Dedicated Fund. Fees for various professions go into this fund, such as fees for interior designers, landscape architects, auctioneers, genetic counselors, and others (for a full list, go to www.idfpr.com). DFPR also transfers some of the monies in those funds to the Professions Indirect Cost Fund to pay for indirect expenses associated with regulated professions; about $31.4 million was transferred in fiscal year 2013. In this way, much of its funding comes from fees rather than state tax revenue.

Raising fees is a perennially contentious subject, with fee payers arguing they already pay enough, and fee administrators citing the rising costs of regulation. What is clear is that fees are a vital pillar in the state government budget, because they fund services that, in the current fiscal climate, general revenues simply cannot. ■

FY 2013 DFPR FEE DEPOSITS BY FUND



DISTRIBUTION OF STATE SALES TAX FLOW CHART

TOTAL STATE SALES TAX RECEIPTS

(6.25% on general merchandise)
(1.0% on food & drugs)

State & Local Sales Tax Reform Fund

20% of net revenue from non-titled UT, SUT; and net monthly revenue from 1% UT, SUT on food & drugs

- 20% appropriated to the City of Chicago
- Transfer 10% to RTA Occupation & Use Tax Replacement Fund
- 0.6% appropriated to Madison County Mass Transit District
- $37.8 million annual transfer (through FY 2025) to Build Illinois Bond Account Fund
- Remainder to LGDF (distributed by population to local governments other than Chicago)

County & Mass Transit District Fund

4% of the preceding month's net revenue from the general 6.25% rate on ROT,SOT, & titled UT

- 4% of the proceeds from the 6.25% general rate on ROT & SOT, appropriated to counties based on retail sales (Cook Co. share to RTA Tax Replacement Fund)
- 4% of the proceeds from the 6.25% general rate on UT on autos appropriated to counties based on auto registrations (Cook Co. share to RTA Tax Replacement Fund)
- Refunds as ordered by the Illinois Department of Revenue

Local Government Tax Fund

16% of the preceding month's net revenues from the general 6.25% rate on ROT, SOT, & titled UT; & net monthly revenue from 1% ROT & SOT on food & drugs

- 16% of the proceeds from the 6.25% auto UT appropriated among cities & counties based on auto registrations
- 16% of the proceeds from the 6.25% general rate on ROT & SOT, apportioned to cities and counties based on retail sales
- Proceeds from the 1% ROT & SOT on food and drugs, apportioned to cities and counties based on retail sales
- Refunds as ordered by the Illinois Department of Revenue

State Tax Fund

80% of the preceding month's net revenue from the general 6.25% rate on ROT, SOT, SUT, & UT

- Net revenue from the sale of some items that were taxed at 1% before Sept. 1, 2009 & are now taxed at 6.25%, to Capital Projects Fund
- Net revenue from the 6.25% tax on some sorbents to the Clean Air Act (CAA) Permit Fund (up to $2 million per fiscal year)
- 1.75% paid into the Build Illinois Fund for MPEA Bonds
- 3.8% paid into the Build Illinois Fund for Build Illinois Bonds
- 0.27% paid into the General Revenue Fund
- Net revenue from the sale of Illinois coal bought by a new electric generating facility that received state aid, to the Energy Infrastructure Fund (for the first 25 years that the facility buys Illinois coal)
- Of the remainder, 25% is deposited in the Common School Special Account Fund & 75% in the General Revenue Fund, with two transfers out
  - *A portion for RTA transferred to the Public Transportation Fund
  - *6/32 of net revenue from local govts with downstate mass transit districts to Downstate Public Transportation Fund

The sales tax consists of two matching pairs of taxes:
1) the retailers' occupation tax (ROT) and the use tax (UT)
2) the service occupation tax (SOT) and the service use tax (SUT)

Other abbreviations:
LGDF= Local Government Distributive Fund
MPEA= Metropolitan Pier and Exposition Authority
RTA= Regional Transportation Authority

FISCAL FOCUS
COMPTROLLER JUDY BAAR TOPINKA
201 State Capitol
Springfield, Illinois 62706-0001

COMPTROLLER JUDY BAAR TOPINKA

WWW.ILLINOISCOMPTROLLER.COM

Like Comptroller Topinka's page on Facebook
https://www.facebook.com/Comptroller.Judy.Baar.Topinka

DID YOU KNOW?

- Fiscal year 2013 base revenues into the General Funds were $36.3 billion, with over 45 percent of that coming from individual income taxes and another 20 percent from sales taxes.
- According to the Commission on Government Forecasting and Accountability, additional General Funds revenues attributable to the 2011 income tax rate increases, which are scheduled to decrease in 2015, will fall by $1.9 billion in fiscal year 2015 and by another $2.9 billion in fiscal year 2016.
- Ten states, including Illinois, have flat individual income tax rates; 33 states have graduated rates; and 7 states have no state income tax.
- Researchers at the University of Tennessee estimated in 2009 that states and local governments would lose $11.4 billion to $12.7 billion in 2012 through non-taxed e-commerce; Illinois' portion of that was about $507 million to $563 million.
- If the $8.526 billion in fiscal year 2013 fee revenues were tracked as a single combined source, they would have been the fourth largest state revenue source that year, trailing only state income taxes, federal aid, and the state sales tax.